No. 86-1839

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

In re: BERRY ESTATES, INC.,

Debtor.

BERRY ESTATES, INC.,

Petitioner,

vs.

HON. EDWARD REGAN,
COMPTROLLER OF THE STATE OF NEW YORK,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND JUDICIAL CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

ROBERT ABRAMS
Attorney General of
The State of New York
Counsel for Respondent
120 Broadway
New York, New York 10271
(212) 341-2663

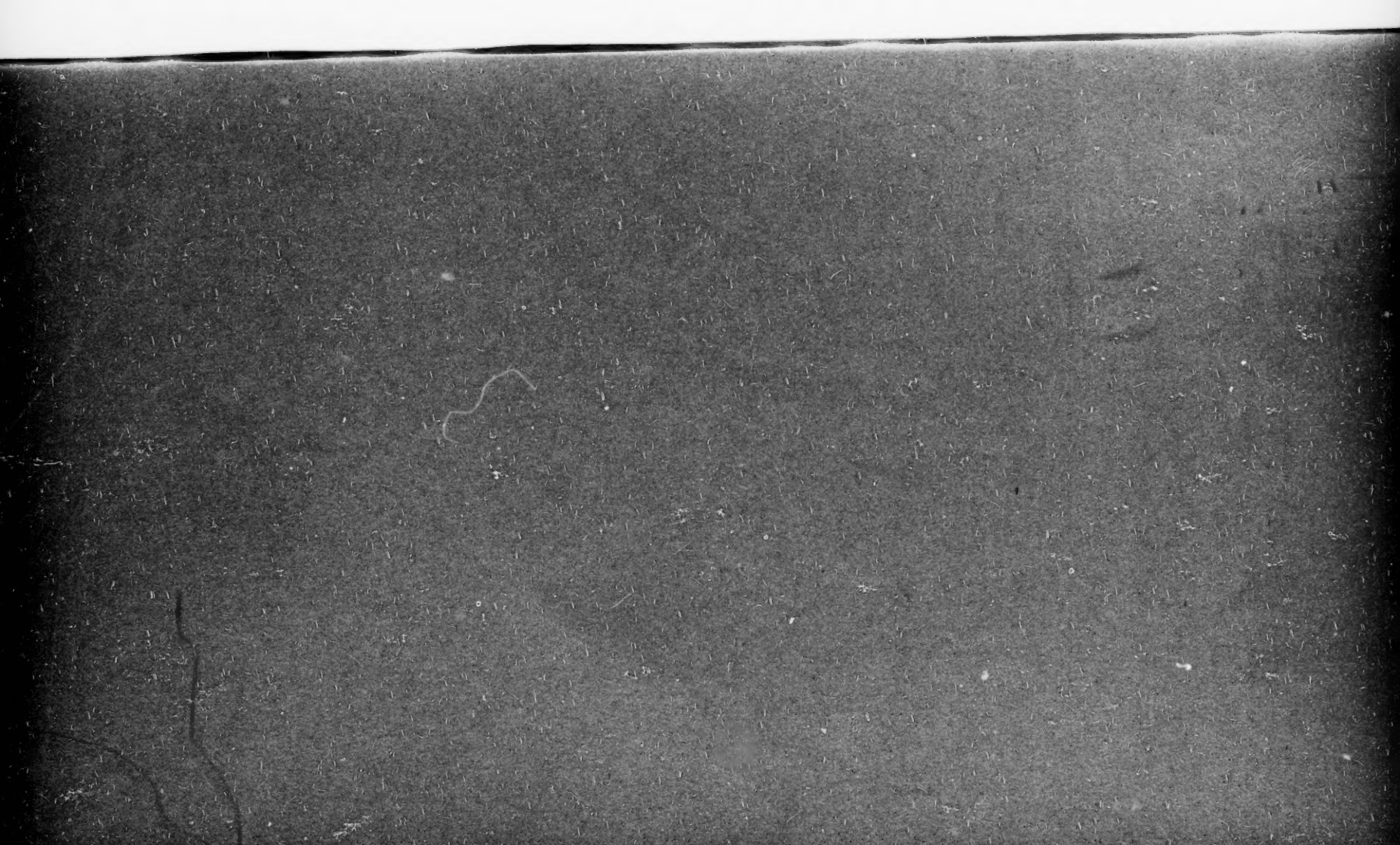
O. PETER SHERWOOD
Solicitor General

LAWRENCE S. KAHN
Deputy Solicitor General

RICHARD G. LISKOV
Assistant Attorney General
Counsel of Record

DAVID S. COOK
Senior Attorney

Of Counsel



QUESTIONS PRESENTED

1. Whether the Comptroller of the State of New York, who is authorized under New York State Finance Law § 8(11) to enforce state court orders requiring the deposit into state court of money to be held in escrow is a "creditor" with a "claim" as those terms are defined by the Bankruptcy Code?

2. Whether certain orders of New York State courts under that state's Emergency Tenant Protection Act of 1974 should control disposition of unlawful excess rents collected by a landlord who thereafter filed for relief under Chapter 11 of the Bankruptcy Code?

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ADDITIONAL STATUTES AND RULES INVOLVED

11 U.S.C. §§ 101(4), (9), 502(b) and New York State Finance Law §§ 8(11) provide:

Title 11, U.S.C. § 101

(4) "claim means –

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, disputed, undisputed, secured, or unsecured.

(9) "creditor" means –

(A) an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.

Title 11, U.S.C. § 502(b)

(b) Except as provided in subjections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that –

(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;

(2) such claim is for unmatured interest;

(3) if such claim is for a tax assessed against property of the estate, such claim exceeds the value of the interest of the estate in such property;

(4) if such claim is for services of an insider or attorney of the debtor, such claim exceeds the reasonable value of such services;

(5) such claim is for a debt that is unmatured on the date of the filing of the petition and that is excepted from discharge under section 523(a)(5) of this title;

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds –

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of –

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease without acceleration, on the earlier of such dates;

(7) if such claim is the claim of an employee for damages resulting from the termination of an employment contract, such claim exceeds –

(A) the compensation provided by such contract, without acceleration, for one year following the earlier of –

(i) the date of the filing of the petition; or

(ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus

(B) any unpaid compensation due under such contract, without acceleration, on the earlier of such dates; or

(8) such claim results from a reduction, due to late payment, in the amoount of an otherwise applicable credit available to the debtor in connection with an employment tax on wages, salaries, or commissions earned from the debtor.

N.Y. State Finance Law (McKinney 1986) provides:

§8. Duties of the comptroller

The comptroller shall: 1. Superintend the fiscal concerns of the state.

* * *

11. Supervise the administration of all the funds paid into any court of record or ordered to be so paid by a judgment, order or decree of any such court of record, and/or paid to the public administrator of any county and/or to the county treasurer of any county to whom letters of administration have been or shall be granted, or to any other administrator having the custody of funds payable to the state comptroller pursuant to the provisions of section two thousand two hundred twenty-two of the surrogate's court procedure act. He shall have power and authority to institute proceedings to enforce obedience to the judgments, orders or decrees of the said courts for the deposit of moneys and securities into court, and prescribe regulations and rules for the care and disposition thereof, which shall be observed by all parties interested therein, unless the court having jurisdiction over the same, shall make different directions by special order duly entered in accordance with article twenty-six of the civil practice law and rules. The comptroller may at any time require any county clerk or clerk of any court of record, to file with any county treasurer an officially certified copy of any record, document or paper, or extracts therefrom, which he may deem necessary for the use of said county treasurer in the administration of such funds . . .

Bankruptcy Rule 3003(c)(3) provides:

FILING PROOF OF CLAIM.

3) "Time for Filing. The Court shall fix and for cause shown may extend the time within which proofs of claim or interest may be filed."

STATEMENT OF THE CASE

Respondent adopts the statement of the case presented in the opinion of the Court below, 812 F.2d at 69-71, (App. 63-66) and asserts that petitioner's Statement of the Case is inaccurate in the following respects:

1. Petitioner's statement (Pet., 31) that its tenants had ample opportunity to present and protect their claims for excess rents ignores the fact that many tenants-creditors could not be found, and thus had no notice of the pendency of the bankruptcy proceedings. As the District Court below observed, "Many tenants failed to leave an adequate forwarding address, and it is implicit in the situation that the Debtor did not go out of its way to preserve permanent addresses for those who moved out while the rent control litigation was pending." (App., 84).

2. In his motion for allowance of his claim, Claim No. 200, the Comptroller argued that he was a "creditor" with a "claim" as those terms are defined in 11 U.S.C. § 101(4),(9)(A). Petitioner's statement (Pet., 33), that the Comptroller argued that he had a "debtor-creditor" relationship with petitioner is correct insofar as it goes; however, the terms "claim" and "creditor", as defined in the Bankruptcy Code, encompass a broader range of the relationships and obligations than traditional "debtor-creditor" concepts, which, generally, were based on economic relations. *See e.g. Ohio v. Kovacs*, 469 U.S. 274, 279 (1982): "There is no indication in the langauge of the statute that the right to performance cannot be a claim unless it arises from a contractual arrangement." Indeed, one of the errors assigned by the Comptroller in his appeal of the District Court's decision was the Court's failure to consider the broadened definitions of the Code. (App., 86-89).

3. Contrary to petitioner's argument (Pet., 35) that 11 U.S.C. § 347(b) applies to the monies claimed by the County Clerk, that section provides, in pertinent part, that funds held by a trustee or debtor in possession which are unclaimed at the end of the time allowed for participation in the distribution under

a confirmed plan become property of the debtor. Where a creditor has timely filed a proof of claim, as the Comptroller did here pursuant to the mandate of N.Y. State Finance Law § 8(11), his right to participate in the distribution pursuant to a plan can be defeated only by disallowance of his claim. Consequently, § 347(b) is inapposite where, as here, debtor's funds are in fact claimed.

4. Although Petitioner correctly recognizes the Comptroller as the party in interest in the litigation concerning Claim No. 200, it incorrectly states: "In its decision and order, the Bankruptcy Court held, *inter alia*, that the Comptroller would be considered a creditor . . . " (Pet., 35).

In fact, the Bankruptcy Court mistakenly stated that the creditor who had filed Claim No. 200 was the Division of Housing and Community Renewal ("the Division") 49 B.R. 1002, 1003 (Bkrptcy. S.D.N.Y. 1985) (App. 90). That Court held that, because the Division was not authorized by state statute to receive payment of the excess rents, its claim would be allowed only to the extent that the Bar Date would be extended for the purpose of finding the missing tenants, and that remaining funds would revert to the Debtor pursuant to 11 U.S.C. § 347(b), 49 B.R. at 1007 (App., 108-110). In contrast, the Court of Appeals held that the Comptroller, as statutory agent for the Rockland County Clerk who was empowered to receive payment, had a claim which was fully allowable, and it ordered the Debtor to pay the claim, 812 F.2d at 72 (App., 69).

REASONS FOR DENYING THE WRIT

Petitioner argues that its petition should be granted because the Courts below erred, and because there is a conflict among the Courts of Appeals. Both arguments are without merit.

Petitioner asserts that the decision of the Court of Appeals "carved out a new exception" to the Bankruptcy Code (Pet., 43) by permitting the State to administer a bankruptcy debtor's property outside the statutory scheme enacted in Title 11, (*id.*), contrary to Congressional intent. Further, Petitioner argues

that because only the Court of Appeals for the Second Circuit has carved out this exception, a conflict of lower courts has arisen which requires review by this Court to resolve. However, in the absence of a contrary opinion from another Circuit, there is no conflict among the Courts of Appeals.

Citing *State of Missouri v. U.S. Bankruptcy Court for the Eastern District of Arkansas*, 647 F.2d 768 (8th Cir. 1981), *cert. denied* 454 U.S. 1162 (1982); *In re Cash Currency Exchange*, 762 F.2d 542 (7th Cir. 1985), *cert. denied*, __ U.S. __, 106 S.Ct. 233 (1986); and *State of Texas v. Wellington Resources Corp.*, 406 F.2d 533 (5th Cir. 1983), petitioner contends that the funds which were the subject of the escrow orders were property of the debtor's estate, as such property is defined in Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, and that the County Clerk of Rockland County was a custodian, as that term is defined in Section 101(10) of the Bankruptcy Code, 11 U.S.C. § 101(10), who was obligated to surrender the funds to the Bankruptcy Court's jurisdiction pursuant to Section 543 of the Bankruptcy Code, 11 U.S.C. § 543. Petitioner then advances the rather novel idea that because the funds are property of the estate in bankruptcy, they are somehow magically exempt from the legitimate claim of the Comptroller who timely filed a proof of claim pursuant to an explicit state statute.

Such has never been the law of bankruptcy. On the contrary, the traditional function of bankruptcy has been to collect and then distribute the debtor's property to his creditors. Assuming *arguendo* that the funds are property of the estate, by timely filing a proof of claim, then moving for its allowance (the genesis of the instant litigation), the Comptroller not only recognized the Bankruptcy Court's exclusive jurisdiction over property of the estate, but participated in the administration of that property within both the spirit and the letter of the Bankruptcy Code.[1] The Court of Appeals, contrary to Petitioner's argument,

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[1] Thus, this case is distinct from the cases cited by Petitioner, where the state authorities were attempting to supersede, through parallel proceedings, the Bankruptcy Court's administration of the estate.

did not carve out a new exception to the Bankruptcy Code, but rather held, in accordance with this Court's decision in *Ohio v. Kovacs*, 462 U.S. 274 (1985), that one way in which states can enforce police powers against debtors in bankruptcy is by filing a claim in Bankruptcy Court and having that claim allowed.

Petitioner also argues that the Comptroller was unauthorized to seek enforcement of the state court escrow orders by filing a claim. (Pet., 54-58). It contends that when creditors may enforce their own private rights against a debtor, a State official may not seek to enforce those same rights for the public's benefit, citing *In re Cannon*, 741 F.2d 1139 (8th Cir., 1984). Unlike *Canon*, the state court order sought to be enforced in this case was expressly in favor of both the individual creditor-tenants *and* the Rockland County Clerk, *see* Order of the Appellate Division of the Supreme Court of the State of New York, Second Judicial Department dated December 7, 1982.[2] Here Petitioner's liability to the private tenant-creditors and the Rockland County Clerk was joint and several; while in *Cannon*, the Missouri

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[2] Although the Court of Appeals did not quote from that order, it referred to it, 812 F.2d at 70 (App. 65): "Following the [New York] Court of Appeals' affirmance the Division moved in the Appellate Division for an accounting by Berry of all excess rents it had collected. The court granted the motion and ordered that Berry pay the Rockland County Clerk all sums collected in excess of the legal regulated rent that had not previously been placed in escrow." The full text of the Appellate Division Order is part of the Record herein. The decretal paragraph is reproduced below:

> Appellants [Berry] are directed to submit to respondents a monthly listing from October 1978 to the present of each subject apartment covered by those orders, the names of the tenants in possession, the length of the lease term, the presently collectable rent, the legal regulated rent, the differential between the legal regulated rent and the presently collectable rent. *Appellants [Berry] are further directed to pay the Rockland County Clerk all sums collected in excess of the legal regulated rent not previously placed in escrow as required by the Appellate Division orders or to return same to the tenants.* [Emphasis added].

Attorney General could not enforce a state court judgment on behalf of consumer creditors absent a judgment in *his* favor, 741 F.2d at 1142. Indeed, the Comptroller had not only the right, but the duty to enforce the Order of the Appellate Division requiring the deposit of money into court. N.Y. State Finance Law § 8(11).[3] *See, Gardner v. New Jersey*, 329 U.S. 565, 575 (1947).

Petitioner's argument that the Court below, by allowing a state to file a proof of claim for the benefit of others, circumvents the Bankruptcy Code, (Pet., 57) is unfounded. Nothing in the Bankruptcy Code precludes two or more parties with claims arising from the same transaction or right from each having a claim or being a creditor, as those terms are defined in 11 U.S.C. § 101(4), (9)(A). In addition, as this Court has recognized as long ago as 1952, the fact that a creditor claims for the benefit of another creditor is immaterial to the allowance of the claim. *Nathanson v. N.L.R.B.*, 344 U.S. 25 (1952). The position of the Comptroller here is akin to that of an indenture trustee who cannot locate all of the beneficiaries of his trust. *See In re Paramount Publix Corporation*, 72 F.2d 219 (2nd Cir. 1934) and in *In re United Cigar Stores Co.*, 68 F.2d 895 (2nd Cir. 1934) where the claim of just such an indenture trustee was allowed.[4] The Comptroller's position as a trustee is confirmed by statutes which charge him with the duty of enforcing orders requiring the deposit of money into court, N.Y. State Finance Law § 8(11), and which provide that legal title, but not equitable title to moneys so deposited vests in the County Clerk, N.Y. Civ. Prac. Law and Rules § 2601(c) (McKinney 1984).

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[3] Petitioner's reliance on *Cannon* is misplaced also, in that contrary to its unsupported statement (Pet., 55, 56), the Emergency Tenant Protection Act, N.Y. Unconsol. Laws §§ 8621-8634 (McKinney 1986) "the ETPA", as of June 1, 1983 (the date of the filing of the bankruptcy petition) did *not* provide that tenants would have a private right of action if wronged by a landlord's violation. The tenant's right of action was added to the ETPA later that month, *see* Ch. 403 McKinneys Laws of 1983, eff. June 30, 1983.

[4] *See also, Corn Exchange Bank Trust Co. v. Empire Trust Co.*, 206 F.2d 30 (2nd Cir, 1953) which is not to the contrary. There the Court reaffirmed the holding of these two cases, but on the facts before it, did not apply them.

Finally, no better answer to Petitioner's criticism (without authority) that the Court of Appeals "decision in this case allows a state *to continue* to administer a debtor's property by filing a proof of claim on behalf of others . . . " (Pet., 57) is found than the words of Chief Judge Augustus Hand in *Paramount Publix Corporation* case, *supra*:

> " . . . After the date of payment . . . [the bank as indenture trustee] shall hold or distribute it . . . like any other creditor who has received dividends, subject only to the obligations arising under its trust and the law of the state of New York, and *without supervision of the bankruptcy court.*" (Emphasis added.)

72 F.2d at 222-223. Once a claim is paid to a creditor it leaves the jurisdiction of the bankruptcy court—in no way a circumvention of Title 11, as Petitioner claims (Pet., 57), but a fulfillment of the Bankruptcy Code's purpose.

Petitioner confuses matters by emphasizing the discussion in the opinion of the Court of Appeals of the police and regulatory powers of the State, 812 F.2d at 71 (App., 67, 68). Petitioner does not challenge the Court's discussion of the proper balance to be struck between the state's police powers and the authority of the Bankruptcy Court, 812 F.2d at 71 (App., 68), but argues that the Court of Appeals "recast" the escrow order of the State court "into a penalty" (Pet., 42). Petitioner further argues that that erroneous characterization led the Court below into the additional error of holding that the escrow order could be enforced by the Comptroller under the exception to the Section 362(a) stay (provided by Section 362(b)(4), (5) and the cases of this Court cited by Petitioner (Pet., 39, 40) applying the statutory exception) because it was a penalty.

Petitioner correctly points out (Pet., 41) that neither of the parties view the escrow order as punitive. It erroneously concludes that the enforcement of a non-punitive order by filing a proof of claim would have been barred by the Section 362(a) stay. The issue in this case is not the applicability of the Section 362(a) stay, but whether or not the Comptroller's claim

was properly allowed by the Court of Appeals. Petitioner advances no reason for disallowance under 11 U.S.C. § 502(b) and did not do so in the Courts below. The applicability of Section 362(a) is irrelevant to the issue; nothing in that section precludes a creditor from merely filing a proof of claim in the Bankruptcy Court and seeking to have the claim allowed, as the Comptroller did here. The discussion by the Court of Appeals of the Section 362(a) stay and the Section 362(b) exceptions to it are *dicta*, for as the Court correctly noted, "The State Court actions were brought by Berry and were not subject to an automatic stay, [citation omitted] or an ordered stay." 812 F.2d at 71 (App., 67).

Petitioner advances no other reasons for granting a writ of certiorari.[5] Because the Court below correctly allowed the Comptroller's claim, and no inter-circuit conflict exists, the petition should be denied.

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[5] Although Petitioner presents the Bankruptcy Court's *sua sponte* extension of the Bar Date as a question raised by this Petition, (Pet., 4) it is not addressed in its argument. The issue of the Bankruptcy Court's discretion in this matter was correctly decided by the Court of Appeals, 812 F.2d at 71, (App. 68, 69). *See* Bankruptcy Rule 3003 (c)(3), 11 U.S.C.A. (1984).

CONCLUSION

For the reasons stated above the petition for a writ of certiorari should be denied.

Dated: New York, New York
July 13, 1987

Respectfully submitted,

ROBERT ABRAMS
Attorney General of the
State of New York
Attorney for Respondent
120 Broadway
New York, New York 10271
(212) 341-2663

O. PETER SHERWOOD
Solicitor General

LAWRENCE S. KAHN
Deputy Solicitor General

RICHARD G. LISKOV
Assistant Attorney General
Counsel of Record

DAVID S. COOK
Senior Attorney

Of Counsel

REPLY

BRIEF

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REPLY BRIEF OF PETITIONER

HARVEY S. BARR, ESQ.*
JOSEPH J. HASPEL, ESQ.
Counsel for Petitioner
664 South Main Street
P.O. Box 664
Spring Valley, NY 10977
(914) 352-4080

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Additional Statutes Needed To Reply

11 U.S.C. §§ 101(10), 101(27) and 101(28) provide:

11 U.S.C. §101. Definitions

In this title --

(10) "custodian" means -

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;

(B) assignee under a general assignment for the benefit of the debtor's creditors; or

(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors;

(27) "indenture" means mortgage, deed of trust, or indenture, under which there is outstanding a security, other than a voting trust certificate, constituting a claim against the debtor, a claim secured by a lien on any of the debtor's property, or an equity security of the debtor;

(28) "indenture trustee" means trustee under an indenture;

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1986

BERRY ESTATES, INC., Petitioner,

v.

HON. EDWARD REGAN, COMPTROLLER OF THE STATE OF NEW YORK,

REPLY BRIEF IN FURTHER SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND JUDICIAL CIRCUIT

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Berry Estates, Inc., the petitioner herein, submits this Reply Brief in further support of its petition requesting that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Judicial Circuit entered in the above-entitled case on February 19, 1987.

REPLY TO RESPONDENT'S "QUESTIONS PRESENTED"

The first question presented by the Respondent asks:

> Whether the Comptroller of the State of New York, who is authorized under New York State Finance Law §

> 8(11) to enforce state court orders requiring the deposit into state court of money to be held in escrow is a "creditor" with a "claim" as those terms are defined by the Bankruptcy Code? (emphasis added)

This "question presented" ingeniously contemplates only one-half of the true issue at bar - specifically, the simple question of whether an escrow agent may file a claim on behalf of escrow beneficiaries when the debtor did not escrow monies prior to the filing for relief under the Bankruptcy Code. It is respectfully submitted that to complete this "question," so that it accurately presents the issue at bar, one must ask the follow up question: If an escrow agent may file a claim on behalf of the escrow beneficiaries, may the escrow agent keep the escrow fund when the escrow beneficiaries (the true claimants) do not timely file a proof of claim, although ordered to do so, or should these unclaimed funds revert back to the debtor under the clear dictates of 11 U.S.C. §347(b).

Both ends of this question are, to date,

unanswered by this Court and of critical importance to further administration of Bankruptcy cases. This is because until the Second Circuit's decision in this case, it has been apparently accepted law that, under 11 U.S.C §543(b), a custodian (i.e. an escrow agent) of property of the debtor (as defined by 11 U.S.C. §541) must turn over the property of the debtor so that it could be administered through the bankruptcy proceeding.[1] The Second Circuit's decision below would permit custodians to step into the shoes of the true claimants, file a claim on behalf of creditors who were duly notified to file their own proofs of claim, but did not do so, and thereafter allow the custodian to keep the monies unclaimed by the true claimants in derogation of 11 U.S.C §347(b) which clearly provides for the disposition of unclaimed property. It is respectfully submitted

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1. In the instant case, the property was not escrowed prior to the filing of the Petition for bankruptcy relief. Thus, no turnover proceeding was required.

that Congress did not enact 11 U.S.C. §§541 (defining "Property of the Estate"), 543 (defining a custodian and his powers and duties) and 347 so that these sections could be, so easily, circumvented. It would be absurd to believe that Congress would separate the notion of custodian from that of creditor, then require a custodian to turn over property of the estate to the trustee (or debtor in possession as the case may be) to be administered through the bankruptcy proceedings, and, at the same time, allow the custodian to reclaim the property of the estate so that he could control it himself.

The second question presented by the Respondent is also a question which should be addressed by this Court. Yet again, Respondent, misleadingly, only presents one-half of the entire issue at bar. The question reads:

> Whether certain orders of New York State courts under that state's Emergency Tenant Protection Act of 1974 should control disposition of

unlawful excess rents collected by a landlord who thereafter filed for relief under Chapter 11 of the Bankruptcy Code?

The reason the language of this question is misleading is that it suggests that there is a dispute regarding the power of the New York State judiciary to enforce New York Law. In fact, there is no dispute. Of course, the State of New York's judiciary has the power to enforce the laws of the State of New York. This is precisely what occurred in the instant case. During the pendency of the Chapter 11 proceeding, New York State's Division of Housing and Community Renewal ("DHCR") and the Debtor litigated the New York State issues in New York State Courts. Specifically, the central issue of the validity of rent regulation in the Village of Spring Valley, New York was ultimately decided on June 5, 1986 by the New York's Court of Appeals (Spring Valley Gardens Associates v. Marrero, 68 N.Y.2d 627, 505 N.Y.S. 2d 57 (1986)). Moreover, the amount of rent

overcharges for each tenant were determined by administrative proceedings at DHCR. Thus, the state issues, which represent the foundation of the tenants' claims against the debtor, were all adjudicated in New York State courts. The only issues remaining are the pecuniary claims themselves, and whether these claims, which are unclaimed by the true owners, must revert back to the debtor as prescribed by 11 U.S.C §347(b), or whether they may escheat to the state.

REPLY TO RESPONDENT'S STATEMENT OF THE CASE

In Paragraph 1 of his "Statement of the Case", Respondent falsely implies that the Debtor did not adequately notice the true claimants. (Respondent's Brief p. 5) However, Respondent does not cite anything whatsoever which would indicate that the Debtor did not fulfill its notice requirements. This is because Respondent could not do so. In fact, the record in this case will reflect that the Debtor made more of an effort to notify potential claimants

than it was required to do. Yet, it is true that "many tenants-creditors could not be found" (Respondent's Brief p.5). The Court should be aware that the Record of this case will indicate that not only did the debtor make extra efforts to locate claimants through publishing public notices, but DHCR was actively involved in protecting and locating "unknown" tenants, as well as counsel to the tenants' association at the Debtor's apartment complex. All of these parties actively searched for the tenants who disappeared. Thus, the statement of the case, as enunciated by Respondent, brings the true controversy into focus. Specifically, whether 11 U.S.C. §347(b) should be declared ineffective, as the Second Circuit determined, so as to allow a custodian to have greater rights to unclaimed property of the estate than the debtor itself.

Paragraph 2 of Respondent's Statement of the Case deals exclusively with the

legal definitions of "creditor", and "claim". Respondent's assertions of "fact" are not "fact" but legal issues and conclusions which can only be presented on appeal. In Paragraph two, Respondent goes so far as to cite legal authority (Ohio v. Kovacs, 469 U.S. 274, 279 (1982)) to support its statement of fact. Although it would be more appropriate to argue this issue at the time the legal issues are briefed, Respondent's raising of this issue compels a response. Suffice it is to say at this point that Ohio v. Kovacs, supra, was not concerned with a purely pecuniary claim like we have at bar, but whether an obligation under a state court injunction is subject to a discharge in bankruptcy. While it is true that this Court broadly read the definition of "claim" and "creditor" within the context of determining whether an obligation was dischargeable, it is respectfully submitted that the Ohio v. Kovacs case ought not be read so broadly as to grant a custodian the ability to be a

creditor and claim unclaimed property as its own.

Paragraph 3 of the Respondent's Statement of the Case is also more appropriately a legal conclusion than a statement of the case. Respondent asserts that because it, as an undisputed custodian, made a claim, 11 U.S.C. §347(b) ought not be applicable. This statement boldly assumes that the central issue at bar is determined in Respondent's favor. It is interesting to note that the Second Circuit, at best, glanced over this crucial issue, and, at worst, simply disregarded the controlling statutes.

In the Respondent's fourth point within its Statement of the Case, Respondent calls to the Court's attention that the Bankruptcy Court "mistakenly" confused two arms of the executive branch of the government of the State of New York, specifically, the Comptroller of the State of New York and DHCR. One must note that only the DHCR is empowered by the laws of the State of New

York to protect tenants' rights, and accordingly, DHCR intervened in the bankruptcy case to preserve tenants' interests. As stated above, DHCR made efforts to locate the tenants who had disappeared, and DHCR commenced administrative procedures to fix the amounts of the tenants' claims. The Bankruptcy Court recognized the separate functions of the Comptroller and the DHCR. The Comptroller is the overseer of the escrow agent (the Clerk of Rockland County, New York) and DHCR is the protector of tenants (or landlords) within the framework of New York's rent regulation statutes. It was obvious that the Bankruptcy Court was making its best effort, within the structure of the Bankruptcy Code, to protect the interests of tenants who had failed to file timely proofs of claims. After all, prior to the Second Circuit's decision below, it was accepted law that a custodian must turn over property it held to be administered through the bankruptcy proceedings (11 U.S.C. §543), and, conversely, a custodian

could not reclaim property of the estate which was unclaimed by the true creditors and obtain a windfall by adding the funds to its own treasury. Indeed, the Debtor agrees that the Bankruptcy Court erred in recasting the Comptroller's claim as a Claim of the DHCR, and this error has been part of the Debtor's appellate arguments and would naturally be addressed in full in the appeal brief should this petition be granted. The Debtor's position is that under the Bankruptcy Code, it is inappropriate for a custodian to make a claim on behalf of true claimants who, after proper notice, failed to perfect their interests by filing a timely proof of claim.

REPLY TO RESPONDENT'S "REASONS FOR DENYING THE WRIT"[2]

In his "Reasons for denying the Writ",

2. As in his Statement of the Case, Respondent's "Reasons for denying the Writ" is replete with legal arguments which go to the merits of this case. As these arguments are addressed, Petitioner is compelled to respond and will do so in a cursory manner. It should be noted that Petitioner has refrained, as much as possible, from presenting legal arguments as this would be more appropriate in the Appellant's brief.

the Respondent discounts the conflict among the Circuits cited in the initial petition by hollowly asserting "there is no conflict among the Courts of Appeals." To further his spurious argument, the Respondent misleads the Court by asserting, as if there were no controversy, that Respondent has a "legitimate claim." Of course, if Respondent had a "legitimate claim" which gave him pecuniary rights independent of the true claimants, then, maybe, Respondent's argument that it has simply followed the letter of the law would have merit.[3]

Although there is a controversy over the

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3. Throughout this case, Petitioner has argued that Respondent's claim is akin to a class claim made by the State of New York on behalf of the true claimants who failed to file a timely proof of claim. In this vein, the Court is respectfully directed to a recent case in the Tenth Circuit entitled In re Standard Metals Corp., 817 F.2d 625 (10th Cir. 1987) which held that a class proof of claim is impermissible in bankruptcy cases and cannot be used to evade the statutes and rules which require that proofs of claim be individually filed by the true claimants. There are many similarities between the Standard Metals Corp. case and this case which will be brought out in an appeal brief.

legitimacy of Respondent's claim, there is no controversy regarding the fact that the Respondent's claim relates to his power to enforce escrow orders of the State courts. Moreover, there is no controversy regarding the fact that the Respondent would have no claim if the escrow beneficiaries did not have a valid claim. And, there is no controversy regarding the fact that the Respondent's claim is an effort to enforce its police powers as defined by §8(11) of the New York State Finance Law. The issue here is what a state may do when its actions, in the name of "police power", collide with the principles of the Bankruptcy Code. In contrast to the Eighth Circuit[4], the Seventh Circuit[5], the Fifth Circuit[6], the Sixth

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4. State of Missouri v. U.S. Bankruptcy Court for the E. D. of Arkansas, 647 F.2d 768 (8th Cir. 1981), cert. denied 454 U.S. 1162, 102 S.Ct. 1035, 71 L.Ed.2d 318 (1982), In re Cannon, 741 F.2d 1139 (8th Cir. 1984) and Equal Employment Opportunity Commission v. Rath Packing Company, 787 F.2d 318 (8th Cir. 1986).

5. Cash Currency Exchange, Inc., 762 F.2d

(footnotes continued on next page.)

Circuit[7], and the First Circuit[8] which all held that only non-pecuniary issues of the states may continue to be pursued by the states after a debtor has filed for relief under the Bankruptcy Code, the Second Circuit's decision would allow a state to enforce an entirely pecuniary matter relating to claims of third parties outside the jurisdiction of the Bankruptcy Court. Cf. Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. ___, 107 S.Ct. 755, 88 L.Ed. 859 (1986), Kelly v. Robinson, 479 U.S. __, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986) and Ohio v. Kovacs, 469 U.S. 274, 105 S.Ct. 705, 83 L.Ed.2d 649 (1985).

(footnotes continued from last page)

542 (7th Cir 1985), cert. denied, 106 S.Ct. 233 (1986).

6. State of Texas v. Wellington Resources Corp., 706 F.2d 533 (5th Cir. 1983).

7. In re Mansfield Tire & Rubber Co., 660 F.2d 1108 (6th Cir. 1981).

8. Cournoyer v. Town of Lincoln, 790 F.2d 971 (1st Cir. 1986).

The balance of the Respondent's Brief in Opposition contains legal argument which address the merits. As stated above, Petitioner believes that the legal questions presented ought to be fully briefed at the time of appeal. Nevertheless, as Respondent has raised these arguments, Petitioner is once again compelled to respond.

The facts in In re Cannon, 741 F.2d 1139 (8th Cir. 1984) are squarely on point with the case at bar. The issue presented was the power of a state to enforce pecuniary rights of its citizens in a bankruptcy case. The statute involved in the Cannon case is functionally equivalent to the statutes to protect tenants in the instant case. The fact that an escrow order existed in the instant case is immaterial because under 11 U.S.C. §543, if the funds ordered to be escrowed were being held in escrow, these funds would have had to be turned over to the trustee (debtor in possession) to be administered in the

bankruptcy case. It is elementary bankruptcy law that state court escrow orders are superseded by the Bankruptcy Code's administrative functions. The assertion by Respondent that the Debtor's liability to the true creditors and the custodian was "joint and several" ignores 11 U.S.C. §543 and the uncontradicted fact that the Respondent is seeking to claim escrow monies which the true claimants failed to claim. Of course, as the true claimants can not be located, under the decision of the Second Circuit, the custodian will be permitted to keep this money. In other words, funds unclaimed by the true claimants will revert into the treasury of the State of New York as a penalty to the debtor.

Further arguing on the merits, the Respondent takes the position that his status is akin to an indenture trustee and he proceeds to cite cases which state that an indenture trustee may make a claim on behalf of the indenture beneficiaries and thereafter hold the proceeds of the claim

for the indenture beneficiaries. This specious argument is without merit for a number of reasons. First, and most obvious, the Respondent herein is not an indenture trustee as defined by the Bankruptcy Code (see 11 U.S.C. §§101(27) and 101(28). On the other hand, he falls squarely within the Bankruptcy Code's definition of "custodian" (see 11 U.S.C. §101(10). Secondly, the Bankruptcy Code specifically provides that an indenture trustee may file a proof of claim. On the other hand, the Bankruptcy Code does not provide that a custodian may file a proof of claim (see 11 U.S.C. §§501(a) and 543). Thirdly, the law cited by Respondent contemplates the Bankruptcy Act of 1898, which has been repealed, not the controlling Bankruptcy Code of 1978. "Section 543 [of the Bankruptcy Code which defines the rights and duties of custodians] makes important substantive changes in prior law." 4 Collier on Bankruptcy ¶543.01 (15th Ed.).

Finally, Respondent takes exception to Petitioner's argument that the Second Circuit wrongly recast the escrow requirement into a penalty so as to allow it to reach its conclusion. In his obfuscated argument that the Second Circuit did not recast the escrow requirement into a penalty, the Respondent reaffirms that neither of the parties herein view the escrow order as punitive. In that light, the Respondent argues that the Second Circuit's discussion of the automatic stay (11 U.S.C. §362) is inconsequential. Petitioner agrees with Respondent that the Second Circuit's usage of 11 U.S.C. §362 was misdirected. Petitioner agrees that the escrow orders were not punitive. However, these assertions by Respondent do not change the fact that the Second Circuit recast the escrow orders as a penalty and based its conclusion upon that recharacterization. The Second Circuit, quoting Matter of Plaza Realty Investors and Queens

Blvd. Properties Co. v. New York City Conciliation and Appeals Board, 111 A.D.2d 395 (1985), plainly stated:

> Converting the refund to the prior tenants into a fine should the prior tenants not claim the refund guaranteed that petitioner [the landlord] would not benefit from its misconduct.
>
> Id. at 397. See also N.Y. Penal Law §180.55 which makes rent gouging a misdemeanor.

812 F.2d at 69.

With a certainty, the Second Circuit unfairly considered the Debtor a wrongdoer and based its decision upon that determination. However, it is important that the Court note: (1) that there has never been a criminal proceeding; (2) that the validity of rent regulation in the Village of Spring Valley, New York was not finally determined until June 5, 1986, which was both after this objection to claim proceeding was heard by the Bankruptcy Court and after the initial appeal to the District Court was determined; (3) that the Chapter 11 Plan of Reorganization provided that should the New

York Courts ultimately uphold the validity of rent regulation in the Village of Spring Valley, then all tenant claimants who filed proofs of claim would receive 100% of their allowed claim plus interest; and (4) the true claimants who properly filed claims have been paid. With this background, it is respectfully submitted that the Second Circuit's recharacterization of Respondent's claim presents a gross injustice to the Debtor.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

BARR AND FAERBER
Counsel for Petitioner
664 South Main Street
P.O. Box 664
Spring Valley, NY 10977
914-352-4080

Of Counsel:

Harvey S. Barr, Esq.
Joseph J. Haspel, Esq.